



**COMMENTS TO THE U.S. TREASURY DEPARTMENT AND THE INTERNAL REVENUE
SERVICE ON THE PROPOSED “SERIAL INVERTER” RULE
JUNE 10, 2016**

Docket Name: Inversions and Related Transactions (REG-135734-14)

Docket Number: IRS-2016-0015-0002

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Americans for Tax Fairness is a diverse [coalition of 425 national and state endorsing organizations](#). Collectively, we represent tens of millions of members whose interests range from education and health care to labor rights and main street business, but our common interest is in a tax code that is fair and raises adequate revenue to meet our country’s growing needs.

We believe the proposed Inversions and Related Transactions regulation is a strong step in the right direction to stop a very serious threat to the loss of federal revenue through U.S. corporate inversions. At the same time, we believe that Treasury has the legal authority to do much more to eliminate the tax avoidance tactics used by expatriating corporations.

We are very concerned about the substantial loss of U.S. tax revenues as a result of U.S. companies changing their tax residence to a foreign country. In Section 7874 of the tax code enacted in 2004 Congress sought to prevent U.S. companies from expatriating for tax-avoidance purposes. At that time, corporate inversions involved a U.S. company merging with a smaller foreign company located in a tax haven where it had virtually no physical presence or employees.

Today, U.S. companies are finding ways to get around the anti-inversion provisions of Section 7874. As a result, more firms are moving their legal residence offshore for tax purposes, even as they continue to maintain operations and management in the U.S. This results in less U.S. tax revenue to fund important priorities, such as improving our nation’s infrastructure, educating and training our workforce, and maintaining strong legal protections, all of which help make U.S. business and our economy more vibrant.

The proposed regulation appropriately identifies one means by which firms get around the current statute—through the use of serial inversions. This is when a foreign company, often a former U.S. firm itself, acquires several U.S. companies in succession. With each inversion and/or merger, the foreign firm is able to acquire a larger U.S. firm without tripping the provisions of Section 7874, which prohibit certain U.S. tax advantages when the new foreign

parent company is at least 60% owned by the original shareholders of the former U.S. parent. Having side-stepped the anti-inversion rules, the new foreign parent firm is then in a position to engage in post-merger transactions to strip the remaining U.S. firm of income and access the U.S. firm's untaxed foreign profits—without paying U.S. tax.

Treasury's proposed **Inversions and Related Transactions** rule (Docket ID: IRS-2016-0015-0002) is particularly appropriate in light of this clear pattern of behavior that effectively circumvents the anti-inversion rules established by Congress in Section 7874.

While the U.S. Congress has the authority to address this problem, it has failed to act. Given this inaction, we believe Treasury has acted appropriately in proposing this regulation to strengthen the anti-inversion rules under Section 7874. In fact, we believe Treasury has a duty to act given the substantial systemic risk to the U.S. tax base presented by inversions, including foreign acquisitions of U.S. firms that do not fall squarely within the technical definition of an inversion under Section 7874.

Whether a merger of a U.S. company with a foreign company technically falls within the definition of an inversion under Section 7874 or not, a broad cross-section of the American public is concerned about U.S. companies that change their residence to a foreign country largely for tax purposes and that subsequently use their new status to avoid paying their fair share of taxes. For this reason, we encourage Treasury to expand on its earlier action in Notice 2014-52, *Rules Regarding Inversions and Related Transactions*, pertaining to the indirect use of untaxed foreign earnings, particularly through the use of hopscotch loans. Specifically, we recommend expanding that notice's guidance under Section 956 of the tax code beyond the corporate inversion context as defined in Section 7874.

The longstanding anti-abuse rationale that is the foundation of Section 956 in no way dictates that it be tied to Section 7874; in fact, the very purpose of Section 956 arguably could be thwarted through such an interpretation.

Harvard Law School senior lecturer Stephen Shay, who previously served as Deputy Assistant Secretary for International Tax Affairs in the Treasury Department, argued in a recent [Tax Notes article](#) that Treasury's *existing* Section 956 anti-abuse regulation should apply to any use, direct or indirect, of the untaxed earnings of a Controlled Foreign Corporation, or CFC, by a foreign parent group that holds U.S. property, including 25% or more of the voting stock of a U.S. shareholder of the CFC—regardless of whether the existence of the foreign parent arises due to an inversion.¹ Under this application of the *existing* regulation, Section 956 would not be linked to Section 7874.

Shay and his co-authors also pointed out that the existing Section 956 regulation could be avoided by “de-controlling” the CFC and urged Treasury to close this loophole in the forthcoming regulations, as well, which we endorse.

Treasury's limited action in the most recent proposed final rule should come as no surprise to affected taxpayers, in light of Treasury's earlier actions and announced intent to take additional steps to thwart corporate inversions and related transactions. We hope that Treasury will go further by eliminating other instances of tax avoidance through expatriations and post-merger transactions by multinational firms.

¹ Stephen E. Shay et al, *Tax Notes*, "Treasury's Unfinished Work On Corporate Expatriations" (February 22, 2016), available at

https://dash.harvard.edu/bitstream/handle/1/25499324/Shay_Fleming_Peroni%20Treasury_s%20Unfinished%20Work%20on%20Corporate%20Expatriations%20150tn0933%5B1%5D.pdf?sequence=1